

The construction and sale of 80 houses by a charitable foundation, otherwise exempt from tax under section 101(6) of the Internal Revenue Code of 1939, over a period of 18 months for the sole purpose of raising funds for the support of a church constitute an unrelated trade or business within the meaning of section 422 of the Internal Revenue Code of 1939, notwithstanding the foundation does not contemplate engaging further in such activity. Where, however, such activity constitutes the primary activity of the foundation, it is not entitled to exemption from tax under section 101(6) of the Code.

Advice has been requested whether the construction and sale of 80 houses by a charitable foundation under the circumstances set forth below constitute an unrelated trade or business within the meaning of section 422 of the Internal Revenue Code of 1939.

The instant foundation is exempt from Federal income tax under section 101(6) of the Code. It has assets of 2x dollars and its chief support consists of gifts from its founders. In order to assist a church in obtaining financial support, the foundation with the managerial and financial assistance of its founders constructed 80 houses over a period of 18 months. Such project involved expenditures of 40x dollars. The houses were sold to the church at cost of construction to the foundation, plus a small sales commission. The foundation does not contemplate engaging further in the construction and sale of houses.

Section 421 of the Code imposes a tax on the supplement U net income derived by certain organizations otherwise exempt from tax under section 101 of the Code from any unrelated trade or business regularly carried on by such organizations. Section 39.422-3 of Regulations 118 provides generally that the income of an exempt organization is subject to the supplement U tax only if two conditions are present with respect to such income. The first condition is that the income must be from a trade or business which is regularly carried on by the organization. The second condition is that the trade or business must not be substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101 of the Code.

The regulations further provide that a trade or business is considered to be regularly carried on when the activity is conducted with sufficient consistency to indicate a continuing purpose of the organization to derive some of its income from such activity. An activity may be regularly carried on even though its performance is infrequent or seasonal. A trade or business is considered to be substantially related to the activities for which an organization is granted exemption if the principal purpose of such trade or business is to further (other than through the

production of income) the purpose for which the organization is granted exemption. In the usual case the nature and size of the trade or business must be compared with the nature and extent of the activities for which the organization is granted exemption in order to determine whether the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization was granted exemption. Whether or not an organization is subject to the supplement U tax shall be determined by the application of these tests to the particular circumstances involved in each individual case.

The construction and sale of houses to the extent herein involved, with all of the attendant operations, cannot be considered as an isolated transaction. Such activity extended over a sufficient period of time to be considered as regularly carried on for the purpose of earning income within the meaning of the applicable law and regulations.

The construction and sale of houses is a business of a kind ordinarily carried on for profit and such activity cannot be said to be substantially related to the functions constituting the basis for the tax exemption of the instant foundation, other than through the accrual of earnings through the sale thereof to the church.

Accordingly, it is held that the construction and sale of houses by the instant foundation under the circumstances stated constitute an unrelated trade or business within the meaning of section 422 of the Code.

Even though the instant foundation qualifies for exemption under section 101(6) of the Code, a foundation which engages in the construction and sale of houses as its primary activity is not eligible for such exemption, since in that case it would not be operated exclusively for charitable purposes within the meaning of the section.